

***United States Court of Appeals
for the Second Circuit***



AMICUS BRIEF

77-1342

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

v.

DOUGLAS P. FIELDS, et al.,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

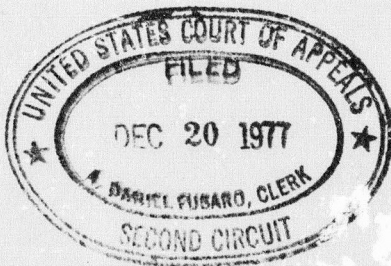
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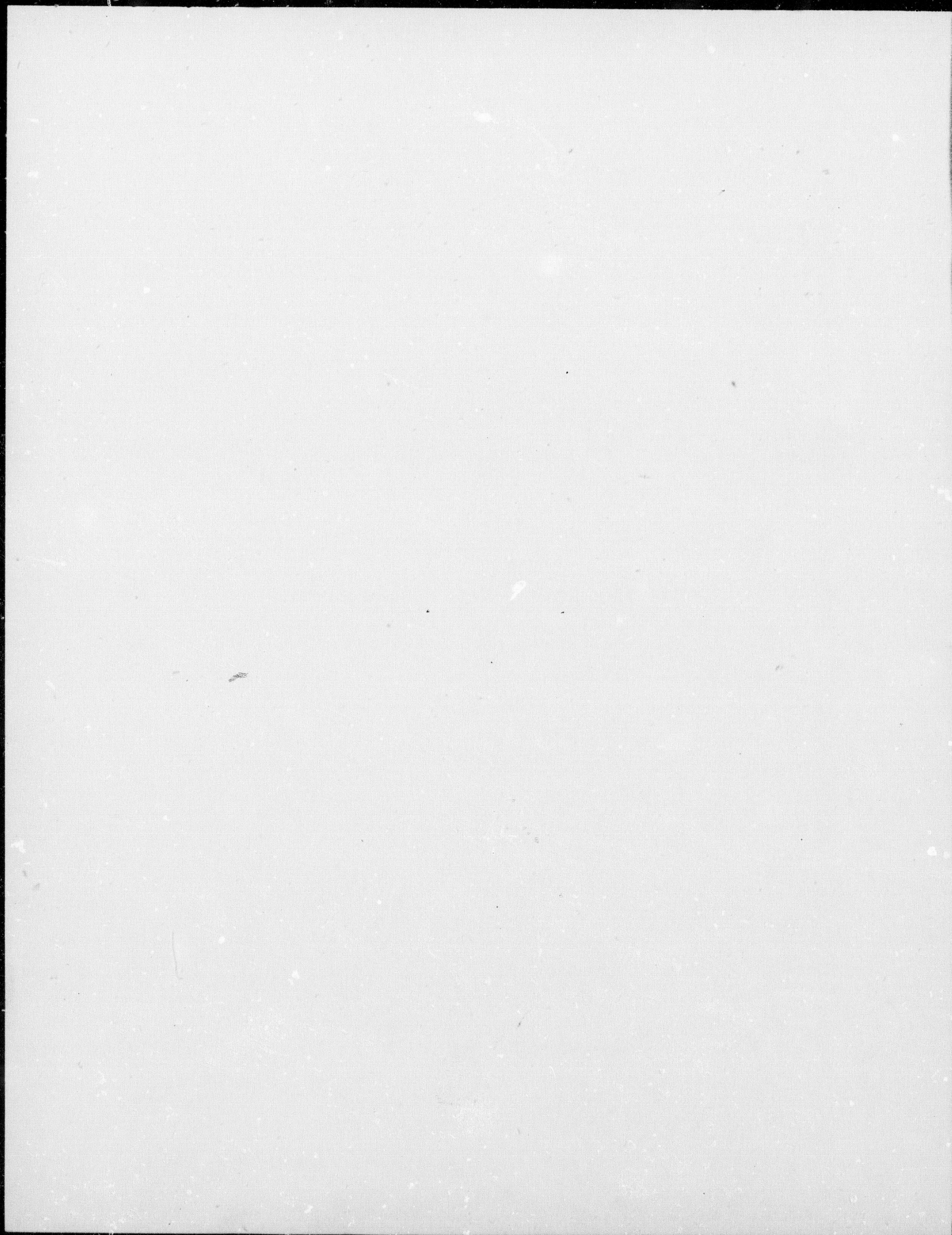
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MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

PRELIMINARY STATEMENT

This is an appeal by the United States from an order (A. 115-116), 1/ entered on June 2, 1977, by the United States District Court for the Southern District of New York (per Haight, J.), which granted a motion by the defendants to dismiss a portion of a twelve-count criminal indictment charging them, among other things, with

1/ "A. __" refers to pages in the Joint Appendix filed in this appeal.

The district court's opinion accompanying the order here under review has not, as yet, been officially reported, but is published at [Current] CCH Fed. Sec. L. Rep. ¶96,074 (S.D. N.Y., Jun. 2, 1977). We have used Appendix citations to the district court's decision wherever we have referred to that court's findings.

- (1) a fraudulent scheme designed to inflate artificially the price of stock in TDA Industries, Inc. ("TDA") prior to a public offering of that company's shares,
- (2) making that offering by means of a false and misleading prospectus that failed to disclose certain material facts, and
- (3) issuing proxy materials that also failed to disclose those material facts. 2/

At the request of the panel of this Court which heard oral argument of the instant appeal, 3/ the Securities and Exchange Commission submits this memorandum, amicus curiae, describing the criminal reference procedures, both formal and informal, followed by the Commission and its staff "during the period [of time] involved in * * * [this] case." 4/

STATEMENT OF THE CASE

Background

The issues raised in this criminal appeal arise in connection with certain alleged activities of members of the Commission's staff participating in the Commission's civil action for injunctive relief instituted on September 16, 1976, against TDA, Westcalind Corp., Douglas P. Fields, Frederick M. Friedman, Peter S. Davis, Eric Berge, and Alan E. Sandberg (A. 41, 51, 151). In its complaint, the Commission had alleged that the

2/ See A. 36-41.

3/ Oral argument was heard on November 16, 1977, before Judges Feinberg, Mansfield and Timbers, and the Court's request to the Commission was dated November 22, 1977. The Court requested that our brief be filed by December 19, 1977.

4/ Of necessity, we construe the Court's request to encompass also a discussion of our informal and formal criminal reference procedures in effect during the time the Commission had under consideration the civil injunctive analogue to this criminal proceeding, Securities and Exchange Commission v. TDA Industries, Inc., et al., (S.D. N.Y., No. 75 Civ. 4519 (LWP)).

defendants had violated, among other things, the registration, 5/ anti-fraud, 6/ reporting, 7/ and proxy 8/ provisions of the federal securities laws in connection with their failure to disclose the payments of unearned "finder's" fees paid for certain corporate acquisitions; the purchase, through a nominee, of TDA stock substantially below its market price; and, the immediate sale, thereafter, of that stock at a substantial profit. Subsequently, the defendants consented to final judgments of permanent injunction against further violations of the aforementioned provisions, without admitting or denying the allegations in the Commission's complaint. In addition, certain of the individual defendants consented, among other things, (1) to disgorge in the aggregate \$580,000 of profits resulting from their alleged violations; (2) to refrain from serving as directors of the corporate defendants for two years; and (3) to refrain from voting their TDA shares for two years. (A. 58-59, 117 n. 2, 150-160, 193-198, 200-204.)

The District Court's Decision

In granting the defendants' motion to dismiss a portion of the twelve-count criminal indictment, the district court struck from that indictment all references to transactions which had been disclosed to the Commission in connection with its injunctive action and consent

5/ Sections 4(a) and 5(c) of the Securities Act of 1933, 15 U.S.C. 77e(a) and 77c(c).

6/ Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5.

7/ Section 13(a) of the Securities Exchange Act, 15 U.S.C. 78m(a), and rules thereunder.

8/ Section 14(a) of the Securities Exchange Act, 15 U.S.C. 78n(a), and Rules 14a-3 and 14a-9 thereunder, 17 CFR 240.14a-3 and 240.14a-9.

thereto because it believed (A. 72, footnote omitted) the Commission's staff had

"engaged upon a deliberate course of concealment, first of their intention to make a criminal reference, and then of the fact that the reference had been made, in order to obtain civil consent judgments imposing substantial sanctions upon defendants." 9/

Although the district court recognized that it had other alternatives to redress the alleged misconduct of the Commission's staff, 10/ it nevertheless dismissed a substantial portion of the government's indictment. 11/ It is from that decision that the government has taken this appeal.

9/ Because this Court, on appeal, is not being asked to reconsider the factual conclusions reached by the district court (U. S. Br. 4), and because the participation of the Commission in this appeal was limited by the Court, we do not here offer any criticism of the district court's findings and of the propriety of its crediting the testimony of an experienced securities lawyer who surely was aware of the Commission's long-standing, and well-known, practice against settling civil actions in any way that would impair subsequent criminal prosecutions. We do not, of course, wish our silence to be construed as acceptance of the district court's critical findings.

10/ See A. 73, where the district court observed that it could admonish the Commission or, alternatively, could permit the defendants to reopen the consent judgments entered in the civil action. Despite its disagreement with the holding of the court below, the Commission offered to permit the reopening of those judgments (A. 128).

11/ Although the district court was critical of the Commission's staff members in this case, it did "not hold that SEC negotiators are obligated, in all circumstances, to keep defense counsel au courant as to their tentative or preliminary thoughts on a future criminal reference; or that equally preliminary conversations between the SEC and a United States Attorney must be promptly revealed" (A. 72, emphasis in original). Rather, it held only (id.)

"that, in the circumstances of this case, the SEC's nondisclosure of the present fact of a criminal reference, viewed in the context of all that had gone before, was inequitable and wrong" (emphasis in original and footnote omitted).

(footnote continued)

DISCUSSION 12/

Since its formation in 1934, a prime responsibility of the Commission has been to assure the fairness, honesty and integrity of this Nation's securities markets, among other things, by assuring that investors are given adequate disclosure of material facts. In enacting the federal securities laws, the Congress recognized that, without vigorous and effective enforcement of these laws, the protections they were intended to effect for investors would be illusory. Accordingly, the Congress gave the Commission an "arsenal of flexible enforcement powers" with which to enforce those laws, Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976).

11/ (footnote continued)

Moreover, despite a motion to dismiss on the ground that the informal criminal reference procedure used in the instant case was improper, the district court expressly "decline[d] to invalidate the working relationship which has grown up between the SEC regional offices and the offices of United States Attorneys in recent years" and concluded "that the SEC may, without violating its governing statutes or its own regulations and procedures, sanction this method of informal criminal references" (A. 69). In this regard, it specifically noted (id.):

"There are sufficient due process safeguards in the grand jury machinery itself, and defendants such as those involved in the present case are not legally entitled to insist that the SEC restrict itself to one particular procedure, even though that procedure, if followed, might have given defendants opportunities to urge, at an administrative level, that no criminal reference be made" (citation omitted).

12/ As noted above, this brief, submitted at the Court's request, is limited to a discussion of the criminal reference procedures, formal and informal, followed by the Commission during the period of time involved in this case. Our silence with respect to other issues discussed and decided by the district court in its opinion does not reflect any acquiescence by the Commission in those determinations.

Thus, the Commission is expressly authorized, inter alia, to investigate possible violations of the federal securities laws, 13/ to issue subpoenas in furtherance of its investigations, 14/ and to seek injunctions in the appropriate district courts of the United States to prevent future violations of those laws. 15/

13/ See Section 19(b) and 20(a) of the Securities Act, 15 U.S.C. 77s(b) and 77t(a); Section 21(a) of the Securities Exchange Act, 15 U.S.C. 78u(a); Section 18(a) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79r(a); Section 321(a) of the Trust Indenture Act of 1939, 15 U.S.C. 77uuu(a); Section 42(a) of the Investment Company Act of 1940, 15 U.S.C. 80a-41(a); Section 209(a) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-9(a).

14/ See Section 19(b) of the Securities Act; Section 21(b) of the Securities Exchange Act, 15 U.S.C. 78u(b); Section 18(c) of the Public Utility Holding Company Act, 15 U.S.C. 79r(c); Section 321(a) of the Trust Indenture Act; Section 42(b) of the Investment Company Act, 15 U.S.C. 80a-41(b); Section 209(b) of the Investment Advisers Act, 15 U.S.C. 80b-9(b).

In addition, the Commission is authorized to seek enforcement of its subpoenas in the appropriate district court. See Section 22(b) of the Securities Act, 15 U.S.C. 77v(b); Section 21(c) of the Securities Exchange Act, 15 U.S.C. 78u(c); Section 18(d) of the Public Utility Holding Company Act, 15 U.S.C. 79r(d); Section 321(a) of the Trust Indenture Act, 15 U.S.C. 77uuu(a); Section 42(c) of the Investment Company Act, 15 U.S.C. 80a-41(c); and Section 209(c) of the Investment Advisers Act, 15 U.S.C. 80b-9(c).

15/ See Section 20(b) of the Securities Act, 15 U.S.C. 77t(b); Sections 21(d) and (e) of the Securities Exchange Act, 15 U.S.C. 78u(d) and u(e); Section 18(f) of the Public Utility Holding Company Act, 15 U.S.C. 79r(f); Section 321(a) of the Trust Indenture Act; Section 42(e) of the Investment Company Act, 15 U.S.C. 80a-41(e); Section 209(e) of the Investment Advisers Act, 15 U.S.C. 80b-9(e).

In the latter connection, the Commission may seek other forms of equitable, ancillary relief, such as an accounting, disgorgement, or the appointment of a receiver. See, e.g., Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F.2d 1082 (C.A. 2, 1972); Securities and Exchange Commission v. Texas Gulf Sulphur Co., 446 F.2d 1301 (C.A. 2), certiorari denied, 404 U.S. 1005 (1971).

In addition, Congress recognized that the criminal prosecution of federal securities law violations was a critical aspect of the comprehensive legislative scheme to protect the investing public, in order to provide "a sufficient guarantee that the rules and regulations of the [Commission] as well as the statutory provisions, will be observed * * *." 16/ Therefore, it provided that certain conduct violative of various provisions of the federal securities laws should also be subject to criminal penalties. 17/ And, to aid in achieving those objectives, Congress authorized the Commission, in connection with each of the statutes which it administers, to refer information indicating violations of these statutes, as well as others, 18/ to the Attorney General, 19/ who, in his discretion, may institute appropriate criminal proceedings. Typical of these provisions, contained in each of the statutes administered by the Commission, is Section 20(b) of the Securities Act, which provides in pertinent part:

"The Commission may transmit such evidence as may be available concerning such acts or practices (which constitute or which will constitute a violation of this title) to the Attorney General who may, in his

16/ See S. Rep. No. 792, 73d Cong., 2d Sess. 6 (1934).

17/ Section 24 of the Securities Act, 15 U.S.C. 77x; Section 32 of the Securities Exchange Act, 15 U.S.C. 78ff; Section 29 of the Public Utility Holding Company Act, 15 U.S.C. 79z-3; Section 325 of the Trust Indenture Act, 15 U.S.C. 77yyy; Section 49 of the Investment Company Act, 15 U.S.C. 80a-48; Section 217 of the Investment Advisers Act, 15 U.S.C. 80b-17.

18/ These may include, for example, charges of mail fraud (18 U.S.C. 1341), wire fraud, (18 U.S.C. 1343), violations of the federal false statement statute (18 U.S.C. 1001), and perjury and subornation of perjury (18 U.S.C. 1621-1622), as well as aiding and abetting (18 U.S.C. 2) and conspiracy (18 U.S.C. 371).

19/ We use the terms Attorney General, Department of Justice, and United States Attorney interchangeably in this memorandum. See 28 U.S.C. 503, 516(a), and 519.

discretion, institute the necessary criminal proceedings under this title." 20/

The Commission, like Congress, recognizes the important role that criminal prosecutions play in the accomplishment of the enforcement objective of the federal securities laws. Accordingly, it is the Commission's policy, discussed infra, to encourage its staff to bring to the attention of United States Attorneys, at the earliest possible stage of an investigation, activities in which the staff believes a United States Attorney may have an interest. This is done in order to facilitate a preliminary determination by the United States Attorney with respect to whether he may have an interest in pursuing further the particular matter and thereby to expedite the process by which such a case may be brought before the Grand Jury.

In the event the United States Attorney is, or would be, interested in pursuing the matter, these preliminary communications serve a number of other purposes designed to promote Congress' ultimate objective of protecting public investors, an objective only recently reaffirmed by Congress. 21/

For example, these communications may help to avoid possible statute of limitations problems. The older the violative conduct is, the less time the United States Attorney may have in which to become familiar with the often complex facts of securities fraud cases, prepare the case,

20/ See also similar provisions in Section 21(d) of the Securities Exchange Act, 15 U.S.C. 78u(d); Section 18(f) of the Public Utility Holding Company Act, 15 U.S.C. 79r(f); Section 321(a) of the Trust Indenture Act, 15 U.S.C. 77uuu(a); Section 42(e) of the Investment Company Act, 15 U.S.C. 80a-41(e); and Section 209(e) of the Investment Advisers Act, 15 U.S.C. 80(b)-9(e).

21/ See H.R. Rep. No. 95-640, 95th Cong., 1st Sess. 10 (Sept. 28, 1977):

"Traditionally, there has been a close working relationship between the Justice Department and the SEC. The Committee [on Interstate and Foreign Commerce] fully expects that this cooperation between the two agencies will continue * * *."

and present it to the grand jury in order to obtain an indictment within applicable time limitations. Besides, an unreasonable delay in bringing criminal charges ultimately may contribute to denying a defendant his sixth amendment right to a speedy criminal trial and, therefore, the policy of encouraging early exchanges of information is beneficial, not only for the purposes of administrative efficiency, but also to protect the rights of potential criminal defendants. In addition, the longer it takes to bring a criminal action, the greater may be the possibility of an objection being raised to the prosecution's use of information developed during the course of the Commission's investigation. Thus, coordination of the timing of civil and criminal proceedings based on similar evidence is often critical. 22/

Preliminary communications between the Commission's staff and the offices of the United States Attorney may assume a variety of forms which the Attorney General of the United States and the Commission have long approved. 23/ To promote their common interests in the "law enforcement business," 24/ the staff of the United States Attorney's Office and the Commission's staff are encouraged to inquire about or discuss, on a regular basis, matters of mutual interest. 25/ In this connection, preliminary

22/ See testimony of John R. Wing, Assistant United States Attorney, for the Southern District of New York and Chief of that Office's Fraud Unit, pp. 1289-1292.

23/ See testimony of Stanley Sporkin, Director of the Commission's Division of Enforcement, p. 677. These preliminary communications are part of "the informal procedure[s]" and "the working relationship which has grown up between the SEC regional offices and the offices of United States Attorneys," which the court below "decline[d] to invalidate" (A. 68-69). See pp. 4-5, n.11, supra.

24/ Testimony of Stanley Sporkin, p. 750.

25/ Id., at 751-752; see also testimony of John R. Wing, pp. 1285-1286.

communications may involve the use of materials such as pleadings in a civil action brought by the Commission, as well as filings with the Commission, or providing the United States Attorney with a basic outline of the relevant facts and materials adduced during a pending Commission investigation.

In cases where the particular United States Attorney indicates his interest in the matter and the investigation is being conducted informally (that is, the Commission has not authorized the issuance of process or the compulsion of testimony), 26/ the Commission's staff need not obtain, and does not seek, Commission authorization before turning over both public and nonpublic investigative materials. 27/ Where, however, a formal investigation is in progress, and the United States Attorney, after preliminary communications, indicates his interest in pursuing the matter further, the Commission itself approves the referral of investigatory materials to the United States Attorney for possible criminal prosecution. A criminal reference may assume two principal forms (discussed immediately below) but, in either event, it is authorized by the Commission. See 17 CFR 202.5(b); and Section 171.08 of the Commission's Manual of Administrative Regulations.

26/ See Section 21 of the Securities Exchange Act, 15 U.S.C. 78u; and 17 CFR 202.5(a).

27/ See 17 CFR 202.5(a) and Sections 171.06 and 171.07 of the Commission's Manual of Administrative Regulations. Procedures for "Cooperation With Federal, State and Foreign Government Authorities and With Self Regulatory Organizations" are set forth in Section 171 of the Commission's Manual of Administrative Regulations, and the authority to act with respect to the matters discussed therein is delegated from the Commission to Division Directors and Regional Administrators and, in the discretion of those officials, to designated members of their staffs. Section 171.02.

It should be borne in mind, of course, that these specific procedures pertain generally to law enforcement agencies, and not expressly to Department of Justice officials, with whom the closest form of cooperation is critical. Moreover, they are promulgated only for the purposes of internal management, and not to confer rights on third parties. Compare Securities and Exchange Commission v. National Student Marketing Corp., 538 F.2d 404, 407 (C.A. D.C., 1976), certiorari denied sub nom. White and Case v. Securities and Exchange Commission, 429 U.S. 1073 (1977), to which Judge Haight referred in his opinion (A. 69).

One type, an informal criminal reference, follows a request by a United States Attorney, generally by letter, that the Commission make all of its investigatory files in the particular case available to that Office. 28/ Such requests are designed to save time in the criminal reference process and are reviewed by the Director of the Commission's Division of Enforcement and the Commission's General Counsel; 29/ who submit the matter to the Commission for its consideration, normally with a recommendation that the files be referred. In these circumstances, when the Commission refers its files, it generally does so without recommending that any action be brought or that particular persons be named as defendants.

The other type of criminal reference, a formal criminal reference, may or may not follow preliminary discussions with the United States Attorney and involves the preparation of a written report by Commission staff members. Such reports generally set forth a detailed statement of the information developed during the course of the Commission's

28/ This is the informal criminal reference procedure to which the district court appears to have referred in its decision (A. 68-69), and which Stanley Sporkin, Director of the Commission's Division of Enforcement, described generally in his testimony before the district court, pp. 667, 669-671, 674-677, 719-720, 750-752. See also testimony of John R. Wing, pp. 1299-1303. This kind of criminal reference is called informal because it does not involve the preparation of a formal report by the Commission's staff, which is discussed at pp. 11-12, infra, and because it promotes administrative efficiency, discussed pp. 8-9, supra. It is to be distinguished from the preliminary communications with the United States Attorney's Office which were also described in the district court opinion and Mr. Sporkin's testimony (see pp. 8-10, supra) because it constitutes a referral of information requiring authorization by the Commission.

29/ See 17 CFR 220.19(b) and 200.21, respectively. Mr. Sporkin testified (618-619) that he has authorized Assistant Directors in his Division to transmit to the Commission recommendations for action. The General Counsel uses a comparable procedure. See also p. 10, n.27, supra.

investigation keyed to the available evidence, an analysis of applicable law, an analysis of the strengths and weaknesses of the case, and recommendations as to who should be prosecuted and for what offenses. After both the Division of Enforcement and the Office of the General Counsel review that report 30/ and make recommendations with respect to it, the Commission determines whether it will refer the report and underlying evidence with its recommendations to the Department of Justice.

The Commission has a long-standing policy of not disposing "of a criminal matter on the basis of" settling an injunctive action. 31/ This policy is well-known to experienced securities counsel. 32/ And, in those few cases where the criminal aspects are resolved as part of the civil settlement, the Department of Justice participates in the negotiations. 33/ In this regard, it is well-known, and statutorily mandated, that the responsibility for initiating, conducting, settling, or otherwise disposing of criminal proceedings for violations of the federal securities laws is vested exclusively in the Attorney General of the United States or his delegates. See, e.g., Section 20(b) of the Securities Act, quoted at pp. 7-8, supra. Thus, assuming that the Commission authorizes the referral of its files to the Department of Justice, that Department exercises its discretion over the conduct of future criminal proceedings, if any, including, in most cases, a decision whether to prosecute a criminal case based, in part, on the materials referred by the Commission. 34/ In almost all cases, however, the Commission retains a continuing interest in the matter

30/ See 17 CFR 220.19(b) and 200.21, respectively; and footnote 29, supra.

31/ See testimony of Stanley Sporkin, pp. 619-624, 635, 637-640.

32/ Id., at 637-640.

33/ Id., at 620-621, 635.

34/ Id., at p. 755.

and authorizes its staff to cooperate fully with the prosecutor's staff who frequently request their assistance. 35/

CONCLUSION

Over the past forty-three years, the Commission has enjoyed a close working relationship with the Department of Justice, enabling both to fulfill their statutory responsibilities of ensuring the integrity, honesty, and efficiency of this country's capital markets. Through the mechanism of both informal and formal criminal references, there is a constant flow of information designed to enhance the law enforcement responsibilities of both agencies, a fact well known to the public and the bar. Although the Commission actively assists the Department of Justice with respect to criminal matters, the Commission, its staff and the securities bar are well aware that it is the Department of Justice, and only the Department of Justice, that may make decisions whether, when and whom to prosecute criminally.

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35/ During the period of time involved in the TDA case, the fiscal year ended June 30, 1976, the Commission made 109 informal criminal references to the Department of Justice and 7 formal criminal references. In the fifteen-month period ended September 30, 1977, the Commission referred, on the same basis, 115 and 6 cases, respectively.